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No. 91-383

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Supreme Court of the United States

OCTOBER TERM, 1991

COMMONWEALTH OF PENNSYLVANIA,
DEPARTMENT OF REVENUE, and
EILEEN MCNULTY, Secretary of Revenue,
Petitioner,

v.

BLOOMINGDALE'S BY MAIL LTD.,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Pennsylvania

MEMORANDUM OF RESPONDENT BLOOMINGDALE'S BY MAIL LTD.

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QUESTIONS PRESENTED FOR REVIEW

1. Whether this Court should overrule its longstanding decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), under which states can impose use tax collection obligations on out-of-state businesses only if they have a "physical presence" in the state.

2. Whether a state court decision interpreting state law to bar the attribution of activities of a related corporation to the respondent (for purposes of determining its "physical presence" within the state) rests on an independent and adequate state ground.

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MEMORANDUM OF RESPONDENT BLOOMINGDALE'S BY MAIL LTD.

STATEMENT

Bloomingdale's By Mail Ltd. ("By Mail")[1] is a New York corporation[1] that conducts a mail order business from its wholly-owned fulfillment center in Cheshire, Connecticut.[2] Pet. App. 6a. It is wholly-owned by Federated Department Stores, Inc. ("Federated"), a Delaware corporation headquartered in Cincinnati, Ohio. Pet. App. 7a.

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[1] Pursuant to Supreme Court Rule 29.1, the Court is advised that Bloomingdale's By Mail Ltd. is a wholly-owned subsidiary of Federated Department Stores, Inc. Bloomingdale's By Mail Ltd. has no subsidiaries.

[2] Prior to May, 1987, By Mail's fulfillment center was located in Salem, Virginia. Unless otherwise noted, references will be to the Connecticut center where all orders are currently filled.

By Mail solicits sales by sending catalogs to prospective customers nationwide, including customers in Pennsylvania. Pet. App. 6a. Customers place orders for merchandise displayed in the catalogs by contacting By Mail directly in Connecticut by mail or by using a toll-free "800" number. *Id.* By Mail then ships the merchandise from Connecticut to these purchasers by common carrier or United States mail. *Id.* By Mail refers its customers to its Connecticut fulfillment center for customer assistance, merchandise return or exchange, and all other customer services. Pet. App. 8a.

At the time of the assessment, By Mail maintained no physical presence whatsoever in Pennsylvania; it conducted all of its business activities from its principal place of business in Cheshire, Connecticut. Pet. App. 6a. By Mail did not operate retail stores, and did not maintain or use any office, distribution house, sales house, warehouse, service enterprise or other place of business in Pennsylvania. Pet. App. 7a. By Mail did not have any solicitors, salesmen, agents or representatives in Pennsylvania. Pet. App. 20a. By Mail had no inventory or merchandise in the state, and was not licensed to do business in Pennsylvania. R. 169a.[3] By Mail had no telephone listing or bank accounts in Pennsylvania, did not retain security interests in any goods sold to Pennsylvania residents, and did not investigate credit or collect accounts in Pennsylvania. R. 169a. By Mail did not design, prepare, print, publish or mail its catalogs in or from Pennsylvania. Pet. App. 7a. By Mail's only contacts with Pennsylvania occurred through the mail, common carriers, and "800" telephones lines.

By Mail's parent company, Federated, also operated retail stores in Pennsylvania through its Bloomingdale's

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[3] The designation "R. ——" refers to the reproduced record filed in the Pennsylvania Supreme Court.

Division.[4] By Mail and Bloomingdale's were separate corporations. The management decisions and day-to-day operations of each corporation were conducted separately, and By Mail was responsible for all expenses incurred in the operation of its business. Pet. App. 19a. To the extent that By Mail obtained financial, legal, real estate or other services from its parent, Federated, it paid a fee for these services pursuant to written agreements. *Id.* By Mail paid a fee to Bloomingdale's for the use of the "Bloomingdale's" trade name and logo. *Id.*

By Mail's customers were not instructed to obtain service or return mail order merchandise to the Bloomingdale's stores; they were instructed to return merchandise directly to By Mail in Connecticut. Pet. App. 8a, R. 171a. As a matter of policy, all customer service was provided at By Mail's Connecticut location and any isolated variation therefrom was an "aberration from normal practice." Pet. App. 18a.

Pennsylvania imposes a tax on the "use . . . within [the] Commonwealth of tangible personal property purchased at retail." Pa. Stat. Ann. tit. 72, § 7202(b) (Purdon 1990). The liability for the tax rests with the consumer, but a person "maintaining a place of business in [the] Commonwealth" is obligated to collect the tax and remit it to Pennsylvania's taxing authorities. *Id.* § 7237(b)(1). The term "[m]aintaining a place of business in [the] Commonwealth" is defined to require either the direct or indirect use of an "office, distribution house, sales house, warehouse, service enterprise, or other place of business" in Pennsylvania, or the presence of a "solicitor, salesman, agent or representative" in Pennsylvania. *Id.* § 7201(b)(1), (2). An out-of-state corporation will

[4] Since July 29, 1988, the Bloomingdale's Division of Federated was separately incorporated as Bloomingdale's Inc. (R. 170a). The term "Bloomingdale's" refers to Bloomingdale's stores originally operated as a division of Federated, and then later incorporated as a separate corporation.

also be deemed to be "maintaining a place of business in the Commonwealth" if it is "[r]egularly or substantially soliciting orders within [Pennsylvania] in connection with the lease, sale or delivery of tangible personal property . . . to residents of [Pennsylvania] by means of catalogues or other advertising . . . ." *Id.* § 7201(b)(3) (cited at Pet. 3-7).

In March 1985 the Pennsylvania Department of Revenue (the "Department") notified By Mail that it must register with the Department and begin collecting Pennsylvania use tax on its mail order sales to Pennsylvania residents because it met the definition of a "person maintaining a place of business in the Commonwealth." Pet. App. 3a-4a. The Department also asked By Mail to produce records of By Mail's sales transactions with Pennsylvania customers, or to notify customers directly that use tax was due on the mail order sales. R. 180a. By Mail took the position that the attempt to impose these duties was an unconstitutional application of Pennsylvania law. By Mail then filed a declaratory judgment action in the Commonwealth Court of Pennsylvania, asking the court to declare that By Mail could not constitutionally be required to comply with any of the Department's requests, and could not constitutionally be required to collect or pay Pennsylvania use tax. Pet. App. 3a-4a.

The Commonwealth Court of Pennsylvania, sitting *en banc* as a court of original jurisdiction, unanimously held that the Department's attempt to require By Mail to collect Pennsylvania use tax on its mail order sales to Pennsylvania residents violated the United States Constitution because By Mail lacked sufficient nexus with Pennsylvania. Pet. App. 21a-22a. The Commonwealth Court applied *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), to find that By Mail lacked nexus with Pennsylvania. In addition to declining to depart from *Bellas Hess* and by finding By Mail's activities did not create a physical presence in the state,

the court also rejected the Department's alternative argument that By Mail had sufficient nexus with Pennsylvania because "it has two affiliated stores in Pennsylvania." Pet. App. 11a. The Department urged the court to ignore By Mail's separate corporate status and attribute the Pennsylvania presence of the Bloomingdale's stores to By Mail. This the court declined to do, stating that "a parent/subsidiary relationship with nothing more will not justify disregarding the separate corporate identity." Pet. App. 21a.

The court also rejected the Department's claim that nexus existed because the Bloomingdale's stores "act as an agent or representative for By Mail." Pet. App. 20a. After reviewing Pennsylvania agency law and the stipulated facts of record, the court refused to find that the Bloomingdale's stores acted as By Mail's agents in Pennsylvania because the standards applied by the Pennsylvania courts to establish an agency relationship had not been met. Pet. App. 20a-21a. As the court explained, under Pennsylvania law, "a true agency relationship results only if there is an agreement for the creation of a fiduciary relationship with control by the principal." Pet. App. 21a (citations omitted). The in-state presence of the separate Bloomingdale's stores was irrelevant for determining By Mail's tax nexus, inasmuch as the Department failed to prove that an agency relationship existed between them under Pennsylvania law. Absent such a relationship, the court was unwilling to "disregard[] the separate corporate identity" and impute the activities of the Bloomingdale's stores to By Mail. Pet. App. 21a.

The Department appealed the decision to the Pennsylvania Supreme Court, which affirmed the lower court's decision without opinion. Pet. App. 1a.[5] The Pennsyl-

[5] In the Pennsylvania Supreme Court two Justices dissented, stating that they "would dismiss the appeal as moot." Pet. App. 1a. In the Pennsylvania Supreme Court, By Mail had noted that it had

vania Supreme Court did not specifically address the Department's express argument that *Bellas Hess* was no longer controlling. This petition followed.

ARGUMENT

THIS COURT SHOULD GRANT CERTIORARI LIMITED TO QUESTION 1 IN THE PETITION

I. QUESTION 1—WHETHER THIS COURT SHOULD OVERRULE ITS DECISION IN *NATIONAL BELLAS HESS v. DEPARTMENT OF REVENUE*, 386 U.S. 753 (1967)—MERITS THIS COURT'S REVIEW

Since the filing of this petition, this Court has granted certiorari in No. 91-194, *Quill Corp. v. North Dakota*, limited to the first question in that petition, namely:

> Whether the North Dakota Supreme Court is obligated to follow the longstanding precedent of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), in a case that is factually indistinguishable from *Bellas Hess*?

60 U.S.L.W. 3221 (U.S. cert. granted Oct. 7, 1991)

In *Quill*, the North Dakota Supreme Court refused to follow this Court's 1967 decision in *Bellas Hess*, finding that "the foundational basis of *Bellas Hess* has been eroded and that the Supreme Court would so conclude." *Quill Corp. v. North Dakota*, No. 91-194, Pet. App. A13. The North Dakota court held that "the tremendous social, economic, commercial, and legal innovations since 1967" had made *Bellas Hess* "an obsolescent precedent." *Quill*, Pet. App. A10. The petition in that case argued

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registered to collect the Pennsylvania use tax on May 1, 1991, because it had opened a By Mail retail outlet in the Commonwealth. The Commonwealth urged that the relief that it sought was not limited to prospective relief, and that the relief encompassed past tax liability. The majority of the Pennsylvania Supreme Court evidently agreed that the pleading should be construed to state a claim for liability for some past period.

that certiorari be granted in part because of a conflict with the decision of the Pennsylvania Supreme Court in this case. *See* Petition for Certiorari *Quill Corp. v. North Dakota*, No. 91-194 at 19-20 (filed Aug. 2, 1991).

In this case, petitioners urge that *Bellas Hess* be reconsidered, presenting as Question 1 in their petition:

> Whether the holding in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967)—that mail-order sellers are exempt from collecting state use taxes unless they have some physical presence within the taxing State—should be reconsidered in light of the technological and other changes in the 24 years since *National Bellas Hess* was decided?

Pet. at i.

We agree that the decision below is based on adherence to this Court's decision in *Bellas Hess* and that, if this Court were to overrule *Bellas Hess* in the *Quill* case, this case would have to be reconsidered in light of *Quill*. Under these circumstances we would ordinarily agree that this case should be held pending this Court's decision in *Quill*. But because of factual differences between this case and *Quill* which could influence this Court's reevaluation of *Bellas Hess*, the Court would be best served by granting certiorari in this case as well, limited to Question 1 in the Petition.[6]

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[6] By Mail notes that a number of cases addressing this issue are pending or have recently been decided. *See, e.g., SFA Folio Collections, Inc. v. Bannon*, 585 A.2d 666 (Conn.), *cert. denied sub nom. Connecticut Commissioner of Revenue Services v. SFA Folio Collections, Inc.*, 111 S. Ct. 2839 (1991); *Cally Curtis Co. v. Groppo*, 572 A.2d 302 (Conn.), *cert. denied*, 111 S. Ct. 77 (1990); *Direct Marketing v. Bennett*, No. Civ. S-88-1067 (E.D. Cal. July 12, 1991) (1991 U.S. Dist. LEXIS 10736) (notice of appeal filed 9th Cir. July 16, 1991); *Bloomingdale's By Mail Ltd. v. Huddleston*, No. 89-3017-II (Tenn.—Davidson Cty. Ch. Ct. March 8, 1991) (appeal pending); *SFA Folio Collections, Inc. v. Huddleston*, No. 89-3015-III (Tenn.—Davidson Cty. Ch. Ct. March 11, 1991) (placed on inactive status pending appeal in *Bloomingdale's By Mail Ltd. v. Huddleston*). By

While there are many similarities between this case and *Quill*, there are also substantial differences. First, the North Dakota court found that Quill owned property in the state, because it licensed to some of its North Dakota residents a computer software program, Quill Service Link ("QSL"), which permits customers direct computer access to Quill's computer. The court held that "[t]hrough its licensing agreement, Quill clearly retains rights to property situated in North Dakota, providing further nexus with the State." *Quill*, Pet. App. A29. The North Dakota court relied on this additional ground in its decision below. *See Quill*, Pet. App. A29-A30. If the decision of this Court in *Quill* were to rest on this alternative ground, the interests of all parties in securing a definitive determination of the continued validity of *Bellas Hess* would be frustrated.

Second, the mail order operations of Quill and By Mail are distinguishable in another respect. Unlike Quill, which sells its office supplies and equipment almost exclusively to businesses, By Mail (and the vast number of mail order sellers) sell to the public at large. This difference in client base may be significant, because sellers encounter additional compliance difficulties when dealing with the general public instead of business establishments. Forcing mail order companies such as By Mail to collect and remit use tax on sales to the general public would entail the same significant compliance burdens that led the Court in *Bellas Hess* to invalidate such requirements when there was no physical presence in the State. The Court held that "[t]he many variations in rates of tax in allowable exemptions, and in administrative and recordkeeping requirements could entangle Na-

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Mail is the appellant in *Bloomingdale's By Mail v. Huddleston*. The chancery court in that case determined that it was not bound by *Bellas Hess*, and By Mail has appealed that decision to the Tennessee Supreme Court. Oral argument in that appeal took place October 3, 1991.

tional [Bellas Hess'] interstate business in a virtual welter of complicated obligations . . . ." *Bellas Hess*, 386 U.S. at 759-60 (footnotes omitted). While many of these same burdens exist when selling to business customers, additional significant problems are presented for firms collecting tax on sales to members of the general public, who make individual purchases in smaller amounts and who are not nearly as sophisticated as business customers. Under such circumstances the calculation of tax and exemptions by customers is prone to error, and mail order businesses encounter substantial difficulties in collecting and remitting the tax actually due from the customer.

This Court would be well served in this important area if it were to have before it two cases presenting differing factual circumstances which would illuminate the basic issue. In similar circumstances this Court has often granted more than one petition for certiorari.

II. THIS COURT SHOULD NOT GRANT CERTIORARI ON QUESTION 2 SINCE IN THIS RESPECT THE DECISION BELOW RESTS ON AN INDEPENDENT AND ADEQUATE STATE GROUND

Although petitioner primarily contends that this Court should "reconsider" and overrule its decision in *Bellas Hess*, petitioner also raises an alternate ground for review. Petitioner contends that By Mail has sufficient nexus with Pennsylvania, even under the *Bellas Hess* rule of physical presence, because By Mail should be deemed to share the nexus that the affiliated Bloomingdale's Division stores have with Pennsylvania. *See* Pet. 29-32. Petitioner raises this alternate ground in Question 2 of the petition:

> Whether, even under *National Bellas Hess*, a mail-order seller is exempt from collecting state use taxes where the seller, although separately incorporated, is closely tied to a well-known retailer with stores in the taxing State, and uses that retailer's name and logo?

Pet. at i.

The Pennsylvania Commonwealth Court[7] treated this issue purely as a question of state corporate and agency law. As a result, the court's decision on this point rests on an adequate and independent state ground and is not subject to further review by this Court. *See generally*, R. Stern, E. Gressman, and S. Shapiro, *Supreme Court Practice* § 3.25 at 168 (6th ed. 1986).

The state court's opinion relied solely on principles of Pennsylvania corporate and agency law in refusing to impute the activities of Bloomingdale's to By Mail. The Pennsylvania Commonwealth Court clearly treated the "affiliate nexus" theory as an issue of state law when it relied on traditional principles of corporate law and refused to treat By Mail's separate corporate status as a "mere legal formality." Pet. App. 19a. The court declined to impute nexus to By Mail solely because affiliated stores were located in the state, noting that "[t]he Pennsylvania Supreme Court has held that a parent/subsidiary relationship with nothing more will not justify disregarding the separate corporate identity and applying a rule different from the normal one." Pet. App. 19a, 21a.

Equally clear is the court's extensive consideration and application of traditional state agency principles in reaching its result:

> Clearly, by Mail does not have agents acting on its behalf in Pennsylvania. Under Pennsylvania law, the burden of establishing the existence of an agency relationship rests on the party making that assertion. *Scott v. Purcell*, 490 Pa. 109, 415 A.2d 56 (1980). A true agency relationship results only if there is an agreement for the creation of a fiduciary relationship with control by the principal. *Mapp v.*

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[7] The Pennsylvania Supreme Court affirmed the lower court's opinion without decision. Thus, the substantive basis for the Court's review in this case is supplied by the decision of the Pennsylvania Commonwealth Court.

> *Gimbel's Department Store*, 373 Pa. Superior Ct. 210, 540 A.2d 941 (1988). However, "agency will not be assumed from the mere fact that one does an act for another." *Reifsnyder v. Dougherty*, 301 Pa. 328, 333, 152 A. 98, 100 (1930).

Pet. App. 20a-21a. Relying on these principles, the court concluded that Pennsylvania lacked nexus with By Mail because the "Bloomingdale's stores in Pennsylvania do not solicit orders on By Mail's behalf nor act as its agents in any fashion." Pet. App. 18a.

The decision shows that the Pennsylvania Commonwealth Court relied exclusively on state principles of corporate and agency law to find that the in-state presence of the Bloomingdale's Division stores was irrelevant to By Mail's tax liability in Pennsylvania. Inasmuch as the Pennsylvania court disposed of the affiliate nexus theory solely on state law grounds, petitioner cannot now resurrect this theory as an alternate ground for review. *See, e.g., Klinger v. Missouri*, 80 U.S. (13 Wall.) 257, 263 (1871); *see also Michigan v. Long*, 463 U.S. 1032, 1037-39 (1983); *Ridgway v. Ridgway*, 454 U.S. 46, 54 (1981); *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 566 (1977).

CONCLUSION

The Court should grant certiorari in this case, limited to Question 1 of the petition. If the Court instead desires to hold this case in light of *Quill Corp. v. North Dakota*, No. 91-194, we respectfully request both parties be provided an opportunity to address the appropriate disposition of this case following the Court's decision in *Quill*.

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